Audit Report

OFFICE OF THE INSPECTOR GENERAL

RECORDING AND REPORTING EXPENSES OF THE DEFENSE COMMISSARY AGENCY

Report No. 97-223 September 30, 1997

DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

Department of Defense

19991012 187

AQI 00-01-0030

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

CONUS	Continental United States
DBMS	Defense Business Management System
DBOF	Defense Business Operations Fund
DeCA	Defense Commissary Agency
DFAS	Defense Finance and Accounting Service
GLAC	General Ledger Account Code

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

September 30, 1997

MEMORANDUM FOR DIRECTOR, DEFENSE COMMISSARY AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Recording and Reporting Expenses of the Defense Commissary Agency (Report No. 97-223)

We are providing this report for review and comment. This is the second in a series of reports dealing with Defense Business Operations Fund expense issues. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Defense Finance and Accounting Service reconsider its position on Recommendation 2. and provide additional comments to this final report by November 28, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9175; e-mail rbird@IGDOD.OSD.MIL); or Mr. Carmelo G. Ventimiglia, Audit Project Manager, at (317) 542-3852 (DSN 699-3852; e-mail cventimiglia @IGDOD.OSD.MIL). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-223 **September 30, 1997**
(Project No. 5FI-2016.01)

Recording and Reporting Expenses of the Defense Commissary Agency

Executive Summary

Introduction. We identified weaknesses in the internal controls for recording and reporting certain expenses of the Defense Commissary Agency during our audit of the expense accounts in the FY 1996 Defense Business Operations Fund financial statements. Financial statement audits are required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

The Defense Commissary Agency is one of the business areas within the Defense Business Operations Fund. Financial reporting for the Defense Commissary Agency is accomplished through three funds. The Commissary Operations Fund and the Commissary Resale Stock Fund are part of Defense Business Operations Fund. The Commissary Surcharge Collections Fund is not part of Defense Business Operations Fund. For FY 1996, the Defense Business Operations Fund reported approximately $6.3 billion of expenses for the Defense Commissary Agency.

In December 1996, the Under Secretary of Defense (Comptroller) announced that the Defense Business Operations Fund would be eliminated and separate working capital funds would be established. The Defense Commissary Agency became a separate working capital fund in FY 1997. This realignment does not affect the matters discussed in this report.

This is the second in a series of reports dealing with Defense Business Operations Fund expense issues. The first report dealt with inconsistencies in calculating and presenting expense account line items for the Defense Business Operations Fund on the FY 1995 Statements of Operations. See Appendix B for details of the report.

Audit Objectives. The overall audit objective was to determine whether the expenses on the FY 1996 Consolidated Financial Statements of the Defense Business Operations Fund were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We also tested internal controls to determine the reasonableness of the assertions made by the management of the Defense Commissary Agency regarding certain expenses on the FY 1996 Statement of Operations.

Audit Results. Internal controls over the recording and reporting of certain expenses were generally adequate. However, Defense Commissary Agency personnel in four of the six regions located in the continental United States did not properly record and report expenses on annual agreements and contracts for services. In addition, Defense Finance and Accounting Service Columbus Center personnel did not follow DoD

guidance in accounting for discounts earned on purchases of goods bought for resale. As a result, for one of the regions, the expense and accounts payable accounts of the Commissary Operations Fund were both overstated by $0.5 million on the FY 1996 financial statements of the Defense Commissary Agency. The expense and accounts payable accounts for three of the other five regions were also misstated because they used similar accounting procedures. In addition, the expense accounts of the Commissary Resale Stock Fund were overstated by $15.6 million on the FY 1996 Statement of Operations. Although the weaknesses we identified did not cause the balances of the expense and accounts payable accounts on the Defense Commissary Agency financial statements to be materially misrepresented, correcting the weaknesses will improve the accuracy of the financial statements.

Summary of Recommendations. We recommend that the Director, Defense Commissary Agency, require the Resource Management Directorate of each region to obtain, as soon as possible after the end of each month, the receiving reports needed to record expenses related to annual agreements and contracts for services. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, accumulate discounts earned on purchases in general ledger account code 6500.1G and include them in calculating the cost of goods sold.

Management Comments. The Executive Assistant to the Director, Defense Commissary Agency, concurred with our recommendation to improve the recording and reporting of expenses by stressing the importance of processing expense transactions in a timely manner. The Defense Commissary Agency instructed the Resource Management Directorate of each region to obtain the receiving reports needed to promptly record expenses related to annual agreements and contracts for services. The Deputy Director for Accounting, Defense Finance and Accounting Service, nonconcurred with our recommendation to reduce the cost of goods sold by the amount of discounts earned on purchases. He stated that the accounting for the movement of funds as a result of the discounts earned must be balanced between the Commissary Resale Stock Fund and the Commissary Surcharge Collections Fund. The Executive Assistant to the Director, Defense Commissary Agency, provided unsolicited comments to the recommendation. She also nonconcurred with the recommendation and stated that the Defense Commissary Agency wants to record the discounts as revenue of the Commissary Surcharge Collections Fund so that they could be passed on to customers. A discussion of the management comments is in Part I and the complete text is in Part III.

Audit Response. The comments of the Defense Commissary Agency on the recommendation to obtain receiving reports were responsive. However, we disagree with the way the Defense Commissary Agency and the Defense Finance and Accounting Service responded regarding the accounting for discounts. The purchase prices of goods should be reduced by the amount of discounts earned when calculating the cost of goods sold. Discounts earned on purchases made by the Commissary Resale Stock Fund should be properly accounted for regardless of the reasons for transferring the amount of the discounts earned to the Commissary Surcharge Collections Fund. The current accounting treatment overstates the expenses of the Commissary Resale Stock Fund on the Statement of Operations. We request that the Defense Finance and Accounting Service reconsider its position and provide additional comments to this final report by November 28, 1997.

Table of Contents

Part I - Audit Results

Audit Background

We identified weaknesses in the internal controls for recording and reporting certain expenses of the Defense Commissary Agency (DeCA) during our audit of the expense accounts in the FY 1996 Defense Business Operation Fund (DBOF) financial statements. We performed the audit to meet the requirements of the Chief Financial Officers Act of 1990 (Public Law 101-576, November 15, 1990) as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). The Chief Financial Officers Act, as amended, requires DoD to prepare annual, audited financial statements for the preceding year and submit them to the Director, Office of Management and Budget. These financial statements report the financial position and results of operations of the DBOF reporting entities.

Management has recognized major deficiencies in the accounting systems of the DBOF, as well as internal control weaknesses and compliance issue problems for many DBOF accounts, including expenses. Although some improvements have been made in the DBOF accounting, numerous problems still exist that will take years to correct. We focused this audit on the recording and reporting of certain expenses for one DBOF reporting entity.

This is the second in a series of reports dealing with DBOF expense issues. The first report dealt with inconsistencies in calculating and presenting expense account line items for the DBOF on the FY 1995 Statements of Operations. See Appendix B for details of the report.

Defense Business Operations Fund. The DBOF was established on October 1, 1991, by merging into a single fund the former stock and industrial funds and the funds of several organizations previously funded by direct appropriations. The providers in the DBOF customer-provider relationship are the business areas. In December 1996, the Under Secretary of Defense (Comptroller) announced that the DBOF would be eliminated and separate working capital funds would be established. DeCA subsequently has had a separate working capital fund since FY 1997. This realignment does not affect the matters discussed in this report.

Funding Sources. Financial reporting for the DeCA reflects its three funding sources: the Commissary Operations Fund, the Commissary Resale Stock Fund, and the Commissary Surcharge Collections Fund. The Commissary Operations Fund and the Commissary Resale Stock Fund were part of DBOF. The Commissary Surcharge Collections Fund was not part of DBOF. DeCA manages each of the funds and the Defense Finance and Accounting Service (DFAS) Columbus Center provides most accounting services.

The Commissary Operations Fund received funds primarily through DBOF and accounted for direct and indirect costs of the operations of DeCA headquarters, regions, and stores. As of September 30, 1996, DeCA reported $982 million in total expenses on the financial statements of the Commissary Operations Fund. The six DeCA regions located in the continental United States (CONUS) reported $856 million in operating expenses in FY 1996.

The Commissary Resale Stock Fund receives cash primarily from sales of grocery items to commissary patrons and disburses cash to replenish the merchandise inventory. As of September 30, 1996, DeCA reported $5.3 billion in expenses on the financial statements of the Commissary Resale Stock Fund. The six DeCA regions located in CONUS reported $4.9 billion in cost of goods sold in FY 1996.

The Commissary Surcharge Collections Fund, which was not part of the DBOF, receives cash primarily from a 5-percent surcharge that commissary patrons are assessed on purchases they make. Cash is used to pay for operations of existing commissary stores and construction of commissary stores.

Audit Objectives

The overall audit objective was to determine whether the expenses on the FY 1996 Consolidated Financial Statements of the DBOF were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We also tested internal controls to determine the reasonableness of the assertions made by the management of the DeCA regarding certain expenses on the FY 1996 Statement of Operations. See Appendix A for a discussion of the audit scope, methodology, and management control program. See Appendix B for a summary of prior audit coverage related to the audit objectives.

Recording and Reporting Expenses

Expenses related to annual agreements and contracts for services were not properly recorded and reported. This occurred because DeCA personnel in four of the six CONUS regions did not adjust the estimated expenses entered in the accounting system with more accurate information on receiving reports and disbursement vouchers. In addition, DFAS Columbus Center personnel did not follow DoD guidance in accounting for discounts earned on purchases of goods acquired for resale. As a result, for one of the regions, the expense and accounts payable accounts of the Commissary Operations Fund were both overstated by $0.5 million on the FY 1996 financial statements. The expense and accounts payable accounts for three of the other five regions were also misstated as they used similar accounting procedures. In addition, the expenses of the Commissary Resale Stock Fund were overstated by $15.6 million on the FY 1996 Statement of Operations. Although the weaknesses identified were not material to the financial statements, correcting the weaknesses will improve the accuracy of the financial statements.

Guidance for Recording and Reporting DeCA Expenses

DeCA Directive 70-7. DeCA Directive 70-7, "Resource Management, Financial Management for Headquarters and Regions," June 28, 1996, provides guidance for recording and reporting expenses chargeable to the Commissary Operations Fund and the Commissary Surcharge Collections Fund. Transactions may be recorded in accounting records as they occur or on an accrual basis at the end of each month. Accrual accounting recognizes the accountable aspects of financial transactions or events as they occur. Reasonable estimates (accruals) of the cost of services should be made at the end of an accounting period when the actual cost of a service is not known. At the same time an expense is recorded in the Defense Business Management System (DBMS), an accounts payable for the same amount is recorded. Resource managers in each of the six CONUS regions are responsible for processing accruals accurately and promptly.

The regions annually enter into agreements and contracts for services, such as for stocking shelves at commissary stores with goods acquired for resale. Commissary stores accepting the services must prepare and forward documents acknowledging the receipt and cost of the services to the resource managers for their regions to ensure that expenses are accurately recorded for the month. Documents acknowledging the receipt of services must also be sent to the DFAS Columbus Center so that payments can be made. If actual cost data are not available to resource managers, estimates of the expenses should be proportionately accrued each month based on the annual contract value.

DeCA Directive 70-7 requires resource managers to reconcile the monthly estimates with actual expenses. An adjustment should be recorded to reflect variances between estimated and actual expenses and to adjust accounts payable.

DoD Guidance for Preparing Financial Statements. "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996, provides a crosswalk from the DoD Uniform Chart of Accounts to the financial statements. The crosswalk for the Statement of Operations shows that general ledger account code (GLAC) 6500, Cost of Goods Sold, and related subsidiary accounts make up line 10, Cost of Goods Sold. One such subsidiary account in the Standard Finance System is GLAC 6500.1G, Cost of Goods Sold - Inventory Gains - Discounts Earned. Vendors sometimes offer DeCA discounts on purchases of goods and services. Discounts are earned when the purchases are paid for within a certain number of days of the invoice date. Expenses should reflect the purchase price of the goods and services by the dollar value of the discounts earned and taken.

Estimated and Actual Expenses

Resource managers at four of the six DeCA regions in CONUS did not properly record and report expenses on annual agreements and contracts for services. Personnel in those four regions recorded estimates of expenses but did not routinely adjust the estimated expenses and accounts payable using more accurate cost data from receiving reports and disbursement vouchers. In the Southwest Region, resource managers recorded the estimated expenses and periodically adjusted the estimated expense using more accurate cost data from receiving reports and disbursement vouchers. Only in the Southern Region did resource managers record the amounts reported on receiving reports instead of recording estimates based on a proration of the annual contract value. We performed a detailed review of expense transactions at two of the four regions that improperly recorded and reported expenses.

Midwest Region. We reviewed 37 expense transactions, valued at about $549,000, for the Midwest Region and found that 16 of the 37 transactions were recorded incorrectly. Recorded expenses were overstated by a net amount of about $30,000. Twelve of the 16 transactions were overstated by $35,946 and 4 transactions were understated by $6,170. Midwest Region personnel did not routinely reconcile estimated expenses with amounts recorded on receiving reports and disbursement vouchers. When they performed reconciliations, they did not ensure that the expenses were recorded in the proper accounting period and recorded only once. In two instances, accounting records included both an estimated expense and the amount recorded on receiving reports. Resource managers failed to eliminate the estimated expense from the records after they had recorded the amount recorded on receiving reports. In addition, Midwest Region personnel did not record four expense transactions in the proper month. Expenses for one contract were not recorded until 4 months after the end of the accounting period and then only an estimate was recorded. Midwest Region

personnel told us that they were aware that monthly reconciliations should be performed, but they had not routinely performed them because of the lack of personnel.

Based on the results of our review and a discussion with Midwest Region personnel regarding the options for recording expenses, the Director of the Midwest Region issued a memorandum on July 21, 1996, addressing recording issues. The memorandum stated that commissary stores within the region must submit receiving documents to the Resource Management Directorate by close of business on the first workday after the end of each month. That practice would allow personnel to initially enter an amount closely approximating the actual expense in the proper period rather than entering an estimate that was not based on the services provided. In addition, when the data were not available, estimates would be required. Based on our work at the Midwest Region, we decided to review how another region recorded expenses related to shelf-stocking contracts. The six DeCA regions had 157 contracts valued at about $50 million for shelf-stocking services covering the 12-month period that included June 1996. The Midwest Region had contracts totaling $10.9 million for that type of service.

Northeast Region. We reviewed 247 transactions, valued at about $5 million, related to shelf-stocking services and found that the expenses related to every transaction were recorded incorrectly. Of the 247 transactions, expenses related to 141 transactions were overstated by $1.6 million and expenses related to 106 transactions were understated by $1.1 million. In addition, Northeast Region personnel did not record 46 of the 247 transactions in the proper accounting period. One of the 46 transactions was recorded in the wrong fiscal year and overstated expenses in FY 1996 by $11,000. Northeast Region personnel did not reconcile estimated expenses with amounts recorded on receiving reports and disbursement vouchers.

The amounts recorded as expenses based on the receiving reports had to be further reduced to reflect discounts taken by the DFAS Columbus Center. As of the time of our review, the DFAS Columbus Center had made payments in FY 1996 totaling about $4.7 million on 212 of the 247 shelf-stocking transactions. Discounts amounting to $19,137 were taken on 75 of the 212 transactions. As of February 1997, resource managers would have had to manually reduce the amounts previously recorded based on receiving reports by the dollar value of discounts taken to reflect actual expenses. This reduction had to be performed manually because the disbursing system that interfaced with DBMS did not separately account for the dollar values of discounts taken. However, a system change request was submitted on November 6, 1995, that will automatically adjust the amount of expenses and accounts payable recorded in DBMS by the dollar value of discounts taken. The scheduled completion date for this system change is December 31, 1999.

Summary. Northeast Region personnel did not record any of the 247 transactions related to shelf-stocking services correctly. Consequently, expenses and accounts payable were overstated by about $0.5 million. The expenses and associated accounts payable on contracts for shelf-stocking services and other types of annual agreements and contracts for services in the other five DeCA regions were also misstated by undetermined amounts. Requiring receiving reports to be promptly forwarded to the regions so that

pertinent cost data can be posted in accounting records would reduce the need for monthly reconciliations, eliminate the recording of accounts payable, and ensure that expenses are recorded accurately. When estimates must be recorded, comprehensive monthly reconciliations should be performed to ensure that operating expenses and accounts payable are correctly presented on the DeCA financial statements and expenses are recorded accurately in the proper period. To properly account for discounts taken, resource managers would have to perform a subsequent reconciliation to reduce amounts recorded based on receiving reports by the dollar value of any discounts taken. The planned system change will automate that process.

Discounts Earned on Purchases of Resale Goods

The DFAS Columbus Center did not properly account for and report discounts earned on purchases. In FY 1996, DeCA earned $15.6 million in discounts for purchases of goods paid for within established time periods. The DFAS Columbus Center initially recorded the discounts in GLAC 6500.1G, Cost of Goods Sold - Inventory Gains - Discounts Earned. Approximately every 2 weeks, the dollar value of discounts earned was transferred to a suspense account and GLAC 6500.1G was adjusted to a zero balance. Subsequently, the dollar value of the discounts was transferred to the Commissary Surcharge Collections Fund in accordance with DeCA Directive 70-6, "Resource Management, Financial Procedures for Commissary Management Support Center," July 23, 1993. While we do not take exception to transferring funds to the Commissary Surcharge Collections Fund as a means of passing the reduction in cost to the customers, we do not agree with the way the DFAS Columbus Center accounted for the discounts. To properly record the cost of goods acquired for resale, DFAS Columbus Center personnel should use GLAC 6500.1G to accumulate the dollar value of discounts earned for the entire fiscal year and offset the cost of goods sold recorded in GLAC 6500 by that amount. In FY 1996, the Cost of Goods Sold shown on the Statement of Operations for the DeCA Resale Stock Fund was overstated by the $15.6 million in discounts earned.

Conclusion

Recording and reporting for certain types of DeCA expense transactions needs improvement. Requiring receiving reports to be promptly forwarded to the Resource Management Directorate of each region and posted in accounting records will reduce the need to perform reconciliations of estimated expenses and actual expenses and ensure that expenses are recorded for the correct amount and in the proper period. When estimates need to be recorded, comprehensive monthly reconciliations should be performed to ensure that operating expenses are correctly recorded in general ledger accounts. Excluding the dollar value of discounts earned from the calculation of cost of goods sold overstates expenses on the Statement of Operations. The DFAS Columbus Center should accumulate the dollar value of discounts earned for the entire fiscal year and use it to offset the cost of goods sold recorded in GLAC 6500.

In FY 1996, operating expenses on line 9, Program or Operating Expenses, were overstated by $0.5 million while line 10, Cost of Goods Sold, was overstated by $15.6 million. In addition, the accounts payable account on the DeCA Statement of Financial Position was overstated by $0.5 million. Accurate accounting records and financial statements can help DeCA management identify financial problems and assist them in making the adjustments needed to improve operations.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Commissary Agency, require the Resource Management Directorate of each region to obtain, as soon as possible after the end of each month, the receiving reports needed to record expenses related to annual agreements and contracts for services. When the reports are not available, Resource Management Directorate personnel should record estimates of the monthly expenses and reconcile the estimated expenses with actual expenses, considering discounts taken.

Management Comments. The Defense Commissary Agency concurred and stated that a memorandum would be issued to the Resource Management Directorate of each region instructing them to obtain the receiving reports needed to promptly record expenses related to annual agreements and contracts for services. The memorandum will also instruct Resource Management Directorate personnel to record estimates of the monthly expenses when the reports are not available and then reconcile the estimated expenses with actual expenses. An adjustment will be recorded to reflect variances between estimated and actual expenses and to adjust accounts payable. The memorandum was issued on June 9, 1997.

2. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, accumulate discounts earned on purchases in general ledger account code 6500.1G, Cost of Goods Sold - Inventory Gains - Discounts Earned, and include them in calculating the cost of goods sold.

Management Comments. The Deputy Director for Accounting, DFAS, nonconcurred to reduce the cost of goods sold by the cumulative amount of discounts earned on purchases. DFAS stated that the accounting for the movement of funds as a result of the discounts earned must be balanced between the Commissary Resale Stock Fund and the Commissary Surcharge Collections Fund. The current DeCA policy is for discounts earned in the Commissary Resale Stock Fund to be transferred to the Commissary Surcharge Collections Fund as revenue. DFAS also stated that a footnote on the Accounting Report 1307 provides full disclosure of the accounting practice used by DeCA in transferring the funds between the two funds.

The Executive Assistant to the Director, DeCA, provided unsolicited comments to the recommendation. She also nonconcurred with the recommendation and stated that the selling prices of goods sold to customers at commissary stores are

not adjusted by the discounts earned. DeCA wants to record the discounts as revenue of the Commissary Surcharge Collections Fund so that the value of the discounts can be passed on to customers. DeCA has concluded that the Commissary Resale Stock Fund cannot include discounts earned in the calculation of cost of goods sold if the discounts are transferred to the Commissary Surcharge Collections Fund and recorded as a revenue.

Audit Response. We disagree with the Defense Commissary Agency and the Defense Finance and Accounting Service comments. We continue to believe that the DFAS Columbus Center did not properly account for discounts earned on purchases made by the Commissary Resale Stock Fund. The purchase prices of goods acquired by the Commissary Resale Stock Fund should be reduced by the amount of discounts earned when calculating the cost of goods sold. Continuing to report the discounts earned as revenue to the Commissary Surcharge Collections Fund will overstate the expenses on the Statements of Operations of the Commissary Resale Stock Fund and the DeCA Working Capital Fund. The footnotes to the FY 1996 Statements of Operations did not disclose the accounting practice used by DeCA in transferring funds between the Commissary Resale Stock Fund and the Commissary Surcharge Collections Fund. We believe the transfer of funds should occur as an equity transfer. Accounting for the transfer of funds in that manner would allow an accurate presentation of the cost of goods sold of the Commissary Resale Stock Fund. We request that DFAS reconsider its position on the recommendation and provide additional comments in response to the final report.

This page was left out of orignial document

Part II - Additional Information

Appendix A. Audit Process

Scope

As part of the audit of expense accounts in the FY 1996 DBOF financial statements, we reviewed how certain expenses incurred by DeCA commissary stores in CONUS regions were recorded and reported on the FY 1996 Statement of Operations. The review concentrated on GLAC 6120.2, Purchased Services - Other, and GLAC 1529.1C, Purchases at Cost. GLAC 6120.2 is used to compute line 9, Program or Operating Expenses, and GLAC 1529.1C is used to compute line 10, Cost of Goods Sold. The two general ledger accounts represented about $5.4 billion (95 percent) of the $5.8 billion in total expenses reported by DeCA CONUS Regions on the FY 1996 Statement of Operations. We did not evaluate the $500 million in expenses for the European Region.

Methodology

The regions located in CONUS use DBMS to account for the operating expenses of the Commissary Operations Fund. The DBMS GLAC 612.5, Other Services, is crosswalked into DoD standard GLAC 6120.2, Purchases Services - Other. About $225 million in expenses was recorded in GLAC 6120.2. We obtained the Midwest Region's DBMS general ledger account history as of May 10, 1996, for Other Services, GLAC 612.5. We judgmentally selected 37 of the 1,417 transactions posted to that general ledger account for review. The 37 transactions were in nine subaccounts and totaled $549,306. Based on our review at the Midwest Region, we decided to review at the Northeast Region a certain type of operating expense that primarily composed one of the subaccounts. We obtained the DBMS document histories as of October 11, 1996, for shelf-stocking contracts. We reviewed 247 shelf-stocking transactions, valued at about $5 million, and reviewed the expenses related to each of the transactions. The transactions we reviewed at the two regions were used in computing the balances of the expense account line items on the Statement of Operations. We also interviewed personnel at the other four regions.

The Standard Finance System is used to account for the cost of goods sold that is reported in the Commissary Resale Stock Fund. The Standard Finance System GLAC 1529.C2, Purchases at Cost - Defense Logistics Agency, and GLAC 1529.C3, Purchases at Cost - All Other, are crosswalked into the standard GLAC 1529.1C, Purchases at Cost. About $5.2 billion in expenses was recorded in GLAC 1529.1C. We obtained the May 1996 general ledger account history for GLAC 1529.C3, Purchases at Cost - All Other, for the Kelly Air Force Base Commissary Store. About $511,950 was recorded in

GLAC 1529.C3 for May 1996. We judgmentally selected for review 30 transactions, valued at $115,589. We also obtained the August 1996 general ledger account history for GLAC 1529.C3 for the Fort Meade Commissary Store. About $4.9 million was recorded in GLAC 1529.C3 for August 1996. We judgmentally selected for review 20 transactions, valued at $232,769.

To assess internal controls and evaluate the process for recording and reporting expense account information on the financial reports of DeCA, we also identified and documented our understanding of transaction cycles and performed limited testing of control policies and procedures designed by management to determine their effectiveness in operation. For the transactions we selected for review, we obtained supporting documents and determined whether the goods and services were authorized and received and recorded correctly as to the amount and in the proper period. In addition, we reviewed the process used by DFAS Columbus Center personnel for preparing the FY 1996 Statements of Operations for the Commissary Operations Fund and the Commissary Resale Stock Fund.

Use of Computer-Processed Data. We relied on the computer-processed general ledger data and financial reports generated by DBMS and the Standard Financial System. We reviewed source documents for selected transactions as part of our evaluation of controls over transactions supporting expense accounts in the FY 1996 Statements of Operations. To the extent that we reviewed the computer-processed data, we concluded that the data were sufficiently reliable to be used in meeting our objectives. We did not audit the systems that produced the data.

Audit Period and Standards. We performed this financial audit from October 1995 through April 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,* requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of management controls to account for and report expenses related to annual agreements and contracts for services and purchases of goods acquired for resale, including the discounts earned on purchases. Management controls

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

for annual agreements and contracts for services were in DeCA Directive 70-7; however, resource managers did not monitor the controls to ensure that they were working as designed. Because we did not identify a material weakness in accounting for and reporting purchases of goods acquired for resale, we did not assess management's self-evaluation.

Adequacy of Management Controls. Management controls were generally adequate as they related to the audit objective. However, we identified specific weaknesses in controls over the recording and reporting of certain types of transactions that caused DeCA expenses and accounts payable to be overstated. Although the weaknesses we identified did not cause the account balances of expenses and accounts payable on the DeCA financial statements to be materially misrepresented, correcting the weaknesses will improve the accuracy of the financial statements.

Appendix B. Summary of Prior Coverage

The Inspector General, DoD, published three audit reports discussing issues related to the recording and reporting of expenses and accounts payable of the Commissary Operations Fund and the Commissary Resale Stock Fund. The three reports are summarized below.

Report No. 97-062, "Consistency in Reporting the Expense Account Line Items of the Defense Business Operations Fund," January 7, 1997. This report states that guidance for reporting operating expenses in the Commissary Operations Fund was incorrect. "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," as amended on November 27, 1995, and DoD 7000.14-R, "DoD Financial Management Regulation," volume 11B, "Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund," December 1994, inappropriately required that the operating expenses of the Commissary Operations Fund be reported on line 10, Cost of Goods Sold, on the Statement of Operations. Consequently, the DeCA FY 1995 Statement of Operations, line 9, Program or Operating Expenses, was misclassified by the $1.1 billion incorrectly reported on line 10, Cost of Goods Sold. A recommendation was made to the Under Secretary of Defense (Comptroller) to revise DoD guidance. The Under Secretary of Defense (Comptroller) concurred with the recommendation and planned to revise volume 11B to require that DeCA operating expenses be reported on line 9, Program or Operating Expenses, on the Statement of Operations.

Report No. 95-228, "Statement of Financial Position for the Commissary Resale Stock Fund, as of September 30, 1994," June 8, 1995. This report states that the internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate Accounts Payable - Transactions With Federal Entities balance. This occurred because DeCA did not reconcile the supporting general ledger account balance to the voucher documentation files. As a result, the $166 million reported on the Statement of Financial Position as Accounts Payable - Transactions With Federal Entities, as of September 30, 1994, could be materially misstated. A recommendation was made to reconcile the general ledger with the voucher documentation files. The DeCA agreed to establish a plan of action for reconciling accounts payable once a detailed listing was available from the DFAS Columbus Center.

Report No. 95-217, "Financial Statements for the Commissary Operations Fund, as of September 30, 1994," June 2, 1995. This report states that the DeCA and DFAS Columbus Center internal control structures over transaction processing and general ledger posting for the Commissary Operations Fund did not provide reasonable assurance that the accounts payable balance presented in the Statement of Financial Position as of September 30, 1994, was accurate. This occurred because DeCA did not establish effective accounting controls over the recording of accounts payable. In addition, the DFAS Columbus Center did not establish an effective review process to ensure the accuracy and integrity of the accounts payable balance. As a result, the $325.9 million accounts payable balance contained overstatement errors of at least $35.8 million and invalid

negative accounts payable of at least $1.45 million. A recommendation was made to the Director, DeCA, and Director, DFAS, to establish procedures to periodically review all accounts payable balances to determine their accuracy and to determine the reliability of account balances produced from DBMS. Management concurred with the recommendations and stated that formal procedures were established to periodically review all accounts payable using statistical sampling.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
  Director for Accounting Policy
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Logistics Agency

Other Defense Organizations (cont'd)

Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Defense Commissary Agency Comments

DEFENSE COMMISSARY AGENCY
HEADQUARTERS
1300 E AVENUE
FORT LEE, VIRGINIA 23801-1800

REPLY TO
ATTENTION OF

IR

MAY 30 1997

MEMORANDUM FOR INSPECTOR GENERAL, FINANCE AND ACCOUNTING DIRECTORATE, 400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Audit Report on Recording and Reporting Expenses of the Defense Commissary Agency (Project No. 5FI-2016.01)

Reference: DoDIG Memorandum, dtd April 30, 1997, SAB

Attached is the DeCA reply to the recommendations provided in subject report. If you have any questions, please contact Mr. Ben Mikell at (804) 734-8103.

Donna J. Willis

DONNA J. WILLIS
Executive Assistant
to the Director

Attachment:
As Stated

DEFENSE COMMISSARY AGENCY REPLY

SUBJECT: Audit Report on Recording and Reporting Expenses of the Defense Commissary Agency (Project No. 5FI-2016.01)

Recommendation 1. We recommend that the Director, DeCA, require the Resource Management Directorate of each region to obtain, as soon as possible after the end of each month, the receiving reports needed to record expenses related to annual agreements and contracts for services. When the reports are not available, record estimates of the monthly expenses and require Resource Management Directorate personnel to reconcile the estimated expenses with actual expenses, considering discounts taken.

DeCA Reply. DeCA concurs with this recommendation. A memorandum will be forwarded to the Resource Management Directorate of each region instructing them to obtain the receiving reports needed to record expenses related to annual agreements and contracts for services. Additionally, in the event that receiving reports are not available, Resource Management Directorate personnel will be instructed to follow guidance as recorded in DeCA Directive 70-7, Resource Management, Financial Management for Headquarters and Regions, June 28, 1996. The memorandum to the regions will also serve as a reminder of the importance of processing receipt and expense transactions in a timely manner. This action will be completed by June 6, 1997.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, accumulate discounts earned on purchases in general ledger account code 6500.1G, Cost of Goods Sold - Inventory Gains - Discounts Earned, and include them in calculating the cost of goods sold.

DeCA Reply. DeCA nonconcurs with this recommendation. DeCA sells goods at the "Standard" cost of items sold. The selling price of goods is not adjusted by the amount of discounts earned. DeCA transfers the total of discounts to the Surcharge Collections Fund, where it is recorded as a revenue, to pass the benefits of the discounts earned to the customer. As stated in the subject report, DoDIG does not take exception to this policy. Based on discussions with DFAS-HQ, DeCA has concluded that the Resale Stock Fund can not include discounts earned in the calculation of cost of goods sold if the discounts are transferred to the Surcharge Collections Fund and recorded as a revenue. If DeCA were to include the discounts earned in the computation of the Resale Stock Fund cost of goods sold and as a revenue to the Surcharge account, the overall positive effect of the discounts would be recorded twice. Since DeCA is transferring the discounts earned to the Surcharge Collections account, the benefit of the discounts is being realized by the Surcharge Collections Fund, not the Resale Stock Fund. As such, DeCA does not agree with including the effect of discounts earned in the calculation of cost of goods sold.

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE
1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

DFAS-HQ/AFC

AUG 12 1997

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Recording and Reporting Expenses of the Defense Commissary Agency (Project No. 5FI-2016.01)

Our comments to the subject report are attached.

If you have any questions, please contact Mr. Robin Ho on (703) 607-1135.

David M. Burton
for
Edward A. Harris
Deputy Director for
Accounting

Attachment:
As stated

cc:
DFAS-HQ/PA

SUBJECT: Audit Report on Recording and Reporting Expenses of the Defense Commissary Agency (Project No. 5FI-2016.01)

Recommendation 2: We recommend that the Director, Defense Finance and Accounting Service Columbus Center, accumulate discounts earned on purchases in general ledger account code 6500.1G, Cost of Goods Sold - Inventory Gains - Discounts Earned, and include them in calculating the cost of goods sold.

DFAS Response: Nonconcur. Based on the conclusion of an April 1997 meeting among representatives of DFAS, DeCA, and the Office of the Under Secretary of Defense (Comptroller), DFAS nonconcurs on this recommendation. The accounting for the movement of funds as a result of the discounts earned must be balanced between the resale part of the Defense Working Capital Fund and the surcharge account. The recommendation would result in the revenues for the amount of the transfer not being recorded in the surcharge fund. DeCA and DFAS are opposed to this accounting treatment as it would understate the revenue available to the surcharge account and merely report a change in the equity for the surcharge account.

The net effect on accumulated operating results on the resale fund using either method would be zero. The DoDIG recommendation would mean that the discounts earned should be an equity transfer to the surcharge account.

The footnotes to the April 30, 1997, AR 1307 financial statements are attached. The COGS section of the footnotes provide full disclosure of the current accounting practice used by DeCA in transferring funds between the two accounts. The footnotes provide the current year and cumulative amounts of discounts earned that have been transferred from resale stocks to surcharge.

Attachment:
As stated

AR 1307 FOOTNOTES
97X4930.5X00
PERIOD ENDING APRIL 30, 1997

Additional Information and Explanatory Material

Cost of Goods Sold (COGS)

Under current DeCA policy, discounts earned in the Resale account are transferred to the Surcharge account as revenue. This causes the Resale COGS to be higher than if the discounts earned were retained in the Resale account. Initially, the dollar value of discounts earned is recorded in the Resale fund under GLAC 6500.1G (COGS-Discounts Earned), which reduces COGS. At month end the discounts earned are reversed out of GLAC 6500.1G in the Resale Fund and transferred and recorded as a revenue in the Surcharge Collections Fund. The net effect on AOR (Accumulated Operating Results) between both funds is zero, but Resale COGS are overstated by the amount of the transfer. This reversal has overstated Resale expenses this fiscal year by $10.3 million on the Statement of Operations. Cumulative Resale operating results reported through FY 1996 have overstated expenses by $65 million.

Other Revenues and Financing Sources

Part I, Line 3 of the Statement of Operations shows an abnormal balance of $(2,456,827.55) due to write-off of uncollectible receivables in current fiscal year. The Type Action transaction code used by the installation accounting office to write off receivables creates a debit balance to the "Miscellaneous Gains" account (GLAC 7193).

Accounts Receivable $(000)

	(1) Accounts Receivable per Activity Records	(2) Adjustment for Undistributed Collections	(3) Allowance for Estimated Uncollectible	(4) Net Amount Due
Intragovernmental	4,875	40		4,915
Governmental	188,759	1,545	(1,491)	188,812
Line 3, Accounts Receivable, Net				193,727

NOTE: In prior reporting periods, cash receivables recorded under RSCs A00/E00 have been adjusted on the Consolidated Trial Balance and reported as collections. The large increase in reported receivables this month is due to the change in the new accounting practice in reporting RSC A00/E00 on the financial statements as receivables and not collections.

Accounts Payable $(000)

	(1) Accounts Payable per Activity Records	(2) Adjustment for Undistributed Disbursements	(3) Net Amount Owed
Intragovern-mental	42,574	1,615	44,189
Governmental	335,640	12,729	348,368
Line 12.A., Accounts Payable,			392,557

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

F. Jay Lane
Richard B. Bird
Carmelo G. Ventimiglia
Gary S. Woodrum
N. Dale Gray
Deborah Curry

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Recording and Reporting Expenses of the Defense Commissary Agency

B. DATE Report Downloaded From the Internet: 10/11/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 10/11/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.